American Insurance Association

2101 L Street. NW
Suite 400
Washington, DC 20037
202-828-7100
Fax 202-293-1219
www.aiadc.org

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BY ELECTRONIC MAIL

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
regs.comments@occ.treas.gov

Board of Governors of the
Federal Reserve System
Attn: Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Federal Deposit Insurance Corporation
Attn: Robert E. Feldman, Executive Secretary
550 17th Street, NW
Washington, DC 20429
comments@FDIC.gov

Re: Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor (OCC Docket ID OCC-2010-0009; FRB Docket No. R-1402 and RIN No. 7100–AD62; FDIC RIN 3064-AD58 and PIN XXXX-XXXX)

Ladies and Gentlemen:

The American Insurance Association ("AIA") appreciates the opportunity to provide comments on the joint notice of proposed rulemaking ("JNPR") of the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Federal Reserve"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively, the "Agencies"), published in the December 30, 2010, Federal Register, and entitled "Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor".[1] AIA represents approximately 300 major U.S. insurance companies that provide all lines of property-casualty insurance to U.S. consumers and businesses, writing more than $117 billion annually in premiums. Our members are interested in the proposed rule-making because it is critical that the Agencies develop risk-based capital standards that are appropriate for nonbank financial companies – including property-casualty insurers.

Property-casualty insurance companies are not currently supervised by the Federal Reserve. We have previously and separately commented that the business model of property-casualty insurers is not likely to present systemic risk and pose a threat to the financial stability of the United States. Accordingly, we would not expect any property-casualty carrier to be designated under Section 113 of the Dodd-Frank Act ("DFA") to be supervised by the Federal Reserve. In the unlikely event that such a designation should occur, however, it is critical that the Agencies employ risk-based capital standards that are suitable and reflective of the risks that are inherent to property-casualty insurers.

Section 171(b) of the DFA requires the appropriate Federal banking agencies to "establish minimum risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board of Governors."[2] This JNPR appears to be the first step in carrying out the Section 171 requirements of DFA to develop the required risk-based capital standards. While the JNPR proposes adjustments in the existing rules that apply to banking organizations, our comments focus on the background discussion within Section I(E) of the JNPR and the proposed rules in Section II(B) because of their relevance to nonbank financial institutions.

Section I(E) correctly acknowledges that there may be situations in which a covered institution will not fit within the traditional risk-based capital framework of depository institutions and will have risks that are not typical of banking institutions:

> *"Certain covered institutions may not previously have been subject to consolidated risk-based capital requirements . . . [and] may be different, with exposure types and risks that were not contemplated when the general risk-based capital rules were developed."*[3]

And later in that section, the JNPR states:

> *"The Board . . . expects that there will be cases when it needs to evaluate the risk-based capital treatment of specific exposures not typically held by depository institutions, and*

[1] 75 *Fed. Reg.* 82317 (December 30, 2010).
[2] Dodd-Frank Act, §171(b)(2).
[3] 75 *Fed. Reg.* at 82319.

that do not have a specific risk weight under the generally applicable risk-based capital requirements."[4]

In its review of the existing risk weight categories, the JNPR also states:

> *" . . . there may be situations where exposures of a depository institution holding company or a nonbank financial company supervised by the Board not only do not wholly fit within the terms of a risk weight category, but also impose risks that are not commensurate with the risk weight otherwise specified in the generally applicable risk-based capital requirements."*[5]

We appreciate the recognition that nonbank financial companies, such as property-casualty insurers, may not – and in fact, do not – possess the same risk characteristics of a banking organization. It goes without saying that property-casualty insurers are not banks. Banks and insurers operate according to different business models and their behavior, activities, and regulatory scheme flow from their respective models. A bank earns profit through the arbitrage of interest rates, attempting to make more interest income from its loans than the interest it pays on its deposits and other funding sources. Thus, its focus is on its asset (loans and investments) portfolio and the maturity structure of its liabilities. A property-casualty insurer, however, principally earns income from the underwriting of risks. Its focus is on the careful management of its underwriting business; investment income is secondary. This core difference between the models results in different risk profiles, which must be recognized in order to develop a meaningful risk-based capital regime for nonbank institutions. We encourage the Agencies to acknowledge this fundamental difference between banks and insurers when proposing risk-based capital requirements for nonbank financial institutions.

The proposed rule section of the JNPR provides a new default risk-weighting for exposures that do not fall within the existing risk weight categories. The impact of the proposal is to provide depository institutions and their holding companies with a default risk weighting category that is lower than the current 100% default. We offer no comment with respect to the implication of this rule change to depository institutions and depository institution holding companies. Our concern is with the language that is used in Section II (B) in reaching the conclusion that a lower default category should be permitted for exposures that fall outside the existing risk weight categories:

> *"To address the appropriate capital requirement for low risk assets that non-depository institutions may hold and for which there is no explicit capital treatment in the general risk-based capital rules, the agencies propose that such exposures receive the capital treatment applicable under the capital guidelines for bank holding companies under limited circumstances."*[6]

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[4] *Id.*
[5] *Id.*
[6] 75 *Fed. Reg.* at 82320.

The language is troubling to us because it implies that the capital guidelines currently applicable to bank holding companies are appropriate for property-casualty insurers. This suggestion is inconsistent with the Agencies' acknowledgement in the JNPR's background section that certain nonbank financial institutions may be different, with exposure types and risks that were not contemplated when the risk-based rules applicable to banking organizations were developed. Any assumption that bank-centric capital standards can be applied to property-casualty insurers is incorrect. We anticipate that additional rule-making will be undertaken in the future to fully develop specific capital adequacy standards that would be applicable to covered nonbank financial institutions. For property-casualty insurers that may become covered institutions, we encourage the Agencies to look to the risk-based capital standards that already exist within the insurance industry as a starting point. State insurance regulators impose a risk-based capital system, which determines various levels of capital requirements based on weighting various risks that an insurer undertakes (e.g., underwriting risks, investment risks, credit risks, etc.). To the extent possible, these concepts should be incorporated into the risk-based capital regime that may apply to designated nonbank financial institutions.

Because many of the particular questions raised in the JNPR are specific to depository institutions, we do not offer a response at this time. Accordingly, we look forward to addressing these questions when the risk-based capital regime for nonbank financial institutions is proposed. Thank you again for this opportunity to comment on the JNPR. We welcome the opportunity to work with the Agencies before and during future rule-making to develop specific risk-based capital adequacy standards for nonbank institutions, and specifically for property-casualty insurers. As always, please do not hesitate to call on us with any questions.

Respectfully submitted,

J. Stephen ("Stef") Zielezienski
Senior Vice President & General Counsel
American Insurance Association
2101 L Street, N.W.
Suite 400
Washington, DC 20037
202-828-7100

Phillip L. Carson
Assistant General Counsel
American Insurance Association
2101 L Street, N.W.
Suite 400
Washington, DC 20037
202-828-7100